

Office of Chief Counsel
Internal Revenue Service

memorandum

CC:WR:LAD:LA:TL-N-4447-99

GMSlavett

date: NOV 10 1999

to: LINDA CUNEO
Statute Coordinator, Los Angeles District

from: District Counsel, Los Angeles District, Los Angeles

subject: [REDACTED]
TL-N-4447-99

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ISSUE

Whether Forms 872 and Forms 872-A, which were not modified to reference S corporations items, extend the statute of limitations for S corporation items under TEFRA audit procedures?

STATEMENT OF FACTS

[REDACTED] ([REDACTED]) is a sub-chapter S corporation. The shareholders of [REDACTED] as reflected on Schedule K-1s for the taxable year [REDACTED], are as follows:

1. [REDACTED] (" [REDACTED] ")
2. [REDACTED] (" [REDACTED] ")
3. [REDACTED] (" [REDACTED] ")
4. [REDACTED] (" [REDACTED] ")
5. [REDACTED] (" [REDACTED] ")
6. [REDACTED] (" [REDACTED] ")
7. [REDACTED] (" [REDACTED] ")

On or about [REDACTED], the Los Angeles District began an audit of [REDACTED] for the tax year ending December 31, [REDACTED]. At a conference held on [REDACTED], the representative of [REDACTED] made representations that [REDACTED] and [REDACTED] were husband and wife and [REDACTED], [REDACTED], [REDACTED] and [REDACTED] were the children of [REDACTED] and [REDACTED]. Based on [REDACTED]'s representative's representation, the revenue agent made an assumption that [REDACTED] was the married name of one of the children. That is, the revenue agent assumed that [REDACTED] and [REDACTED] were married. Accordingly, for purposes of the TEFRA audit procedures, the revenue agent believed that [REDACTED] had only five shareholders and therefore, treated the audit as NON-TEFRA.

As the [REDACTED] statute of limitations for [REDACTED] approached, the revenue agent obtained Forms 872 from [REDACTED] and [REDACTED], [REDACTED], and [REDACTED]. These Forms 872 extend the time to assess individual income tax for the [REDACTED] taxable year to any time on or before [REDACTED]. Further, Forms 872-A were obtained from [REDACTED], [REDACTED] and [REDACTED]. None of the Forms 872 and 872-A were modified to reference S corporation items. No Form 872-S was obtained.

A conference was held on [REDACTED] with the revenue agent, the revenue agent's manager and [REDACTED]'s representative. At the conference, [REDACTED]'s representative alluded to the fact that [REDACTED] and [REDACTED] were not related to [REDACTED] and [REDACTED], but rather were the unmarried children of a physician. This was the revenue agent's first suspicion that [REDACTED] and [REDACTED] were not married. Several months later, at a Form 4502 review held between the revenue agent and her manager, the revenue agent brought forth her concern regarding whether the TEFRA audit procedures may apply. The Seattle District, where [REDACTED] and [REDACTED] reside, was contacted. Upon their review of the original returns, they were able to determine that [REDACTED] and [REDACTED] filed their returns for the [REDACTED] taxable year as single. Accordingly, at that point in time, [REDACTED] was determined to have six shareholders for purposes of TEFRA.

A more detailed explanation of the facts as to why it was initially determined that [REDACTED] was not subject to the TEFRA audit procedures are set forth, and incorporated herein, in the attached memorandum from RA Valerie Collins to the Branch Chief/Branch 5, dated May 12, 1999.

BRIEF ANSWER

It is Counsel's current litigation position that a section 6501(c)(4) extension (Form 872 and 872-A) should not be relied upon for making adjustments to S corporation items absent compelling circumstances. The circumstances surrounding this case do not meet the compelling circumstances standard set forth by the Office of Chief Counsel. Accordingly, we recommend that a notice of final S corporation administrative adjustment (FSCAA) and statutory notices of deficiency not be issued.

DISCUSSION

A. Application of TEFRA Audit Procedures to [REDACTED]

For tax years beginning before 1997, the unified audit procedures applicable to partnerships (known as TEFRA audit procedures) apply to certain S corporations. IRC § 6244.¹ Under TEFRA audit procedures, the tax treatment of any S corporation item of income, loss, deduction, or credit, must be determined at the corporate level. IRC § 6241.

TEFRA audit procedures do not apply to S corporations that are owned by five or fewer shareholders, each of whom is a natural person or an estate. For this purpose, a husband and wife are treated as one shareholder. Treas. Reg. § 301.6241-1T(c)(2)(ii). Since Rama and Saraswathi are the only married shareholders of [REDACTED], [REDACTED] is deemed to have six shareholders and is therefore subject to TEFRA audit procedures.

B. Statute of Limitations

Section 6229 establishes a statute of limitations for S corporation items and affected items based on the filing date of the S corporation return.² The statute of limitations for examination of S corporation items does not expire before three years after the later of: (1) the S corporation return due date (without regard to extension); or (2) the S corporation return filing date. See IRC § 6229(a).

¹ All section references are to the Internal Revenue Code of 1986 as amended and in effect during the period herein involved, unless otherwise indicated.

² While IRC § 6229 refers to partnerships, it is equally applicable to S corporations which are subject to the TEFRA audit procedures. IRC § 6244.

The period of limitations under IRC § 6229(a) may be extended for all shareholders by an agreement entered into by the IRS and the tax matters person (TMP), and may be extended for any shareholder by an agreement entered into between the IRS and that shareholder. See IRC § 6229(b). However, a consent to extend the time to assess tax will not apply to S corporation items unless the agreement expressly provides that such agreement applies to tax attributable to S corporation items. See IRC § 6229(b)(3). Normally, Form 872-S should be used to extend the statute of limitations for all S corporation shareholders as to S corporation items. Further, in Foam Recycling Associates v. Commissioner, T.C. Memo 1992-645, the Tax Court held that Non-TEFRA Form 872-A, could validly extend the period of limitations under IRC § 6229(b)(2) if properly modified.

In our case, the Forms 872 and 872-A which were signed by the shareholders were not modified to reference S corporation items. Accordingly, pursuant to IRC § 6229(b)(3), these statute extensions are probably insufficient to extend the period of limitations under IRC § 6229(a).

However, one fundamental issue which has not been definitively resolved is whether the IRC § 6229 S corporation item statute of limitations is the exclusive S corporation item statute of limitations or whether IRC § 6229 merely operates as an extension of the general shareholder level IRC § 6501 statute of limitations. Support for the latter interpretation is found in the language of IRC § 6229(a) itself which provides that the partnership item statute "**shall not expire before**" three years from the date the partnership return is deemed filed. Section 6501, by contrast, provides that the tax "**shall be assessed**" within the three year period, as extended. Counsel takes this latter position that IRC § 6501 is the controlling limitation on assessment, and that to the extent applicable, IRC § 6229 merely serves to extend the IRC § 6501 general limitation on assessment. That is, the limitation on assessment of tax attributable to S corporation items is the longer of IRC § 6501 or IRC § 6229. Under this position, the signing of Forms 872 and 872-A by a shareholder successfully extends the statute of limitations to the S corporation items as to that shareholder.

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CONCLUSION

It is Counsel's current litigation position that a section 6501(c)(4) extension should not be relied upon for making adjustments to S corporation items absent compelling circumstances. In our view, the circumstances surrounding this case do not meet the compelling circumstances standard set forth by the Office of Chief Counsel. While [REDACTED]'s representative made misleading statements, it does not appear he affirmatively stated that [REDACTED] and [REDACTED] were married, nor does it appear that the Service ever directly asked him whether they were married. Further, the Service could have independently determined [REDACTED] and [REDACTED]'s filing status for the year in question by obtaining a RETVUE or by calling the Seattle District, as was later done. Accordingly, we recommend that an FSCAA and statutory notices of deficiency not be issued.

If you have questions regarding the above, please do not hesitate to contact Attorney Gary M. Slavett at (213) 894-3027 ext. 185.

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By: _____
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